

KAULEY V. LUJAN, Civ. No. 84-3306T

SETTLEMENT AGREEMENT

The parties to this action hereby enter into this settlement agreement providing for the final judgment of the Court under the following terms and conditions.

Background

1. This action was filed in federal court on December 14, 1984, by plaintiffs David Kauley, Mary Limpy and Thelma Haag, who are enrolled members of the Cheyenne-Arapaho Tribes of Oklahoma. On August 10, 1987, the suit was certified as a class action for the class of all Indian allottees who own interests in oil and gas leases on allotted lands within the Anadarko Area. The Complaint sought a declaration that the defendant Department of the Interior's (the "Department") management and administration of the plaintiffs' oil and gas resources did not comply with the requirements of the Federal Oil and Gas Royalty Management Act of 1982 ("FOGRMA" or the "Act") 30 U.S.C. 1701 et seq.

Specifically, plaintiffs alleged that the Department failed to:

- a. Make timely deposits of royalty payments to plaintiffs' Individual Indian Money ("IIM") accounts under 30 U.S.C. 1714;
- b. Pay interest to plaintiffs for the late deposit of royalty payments to IIM accounts pursuant to 30 U.S.C. 1721 d

c. Provide plaintiffs with explanation of payment (EOP) reports containing all the information required by the Act together with the royalty payments pursuant to 30 U.S.C. 1715 (a);

d. Establish a comprehensive inspection, collection and fiscal and production accounting and auditing system to provide the capability to accurately determine oil and gas royalties, interest, fines, penalties, fees, deposits, and other payments owed, and to account for such amounts in a timely manner pursuant to 30 U.S.C. 1711; and,

e. Audit and reconcile, to the extent practicable, all current and past lease accounts for leases of oil and gas and take appropriate steps to make additional collections as are warranted.

2. Plaintiffs claimed that, because of these alleged omissions, the Department's royalty management program failed to comply with FOGRMA and constituted a breach of its trust responsibilities.

3. The parties are not in complete agreement concerning the scope of the duties imposed by FOGRMA or as to the specific method which should be used by the Department to comply with FOGRMA. However, there has been general agreement that FOGRMA requires the Department's program for management of Indian royalties to address and provide for the issues listed above.

The Department has been striving to develop increasingly open communications with the Indian allottees and intends to continue to build a working relationship that is not dependent on the pendency of this suit. The Department has put a great deal of effort into communicating with individual allottees and with allottee organizations and will continue to do so before decisions affecting the management of the allottees' resources are made. Recognizing the substantial common ground existing between the parties' interpretation of FOGRMA, the parties have negotiated this agreement. This agreement governs the Department's actions with regard to all allotted Indian mineral leases other than those authorized by the Indian Mineral Development Act of 1982. Due to the varied and potentially unique terms of certain of those mineral agreements, the Department may not be able to perform all automated fiscal and production accounting, comparison, and exception routines discussed in this settlement agreement. The following provisions memorialize our mutual understanding of the Department's specific standards and requirements for its current program implementing the more general requirements of FOGRMA.

#### Timeliness of Payment

4. The Department deposits payments received from lessees and payors into plaintiffs' IIM accounts by the end of the calendar month following the calendar month in which the Department receives the payment. The Department provided

quarterly reports for 1990 which show that 94.5 percent of all payments received by the Department in one calendar month were deposited to the IIM accounts by the end of the following calendar month. The Department believes that it can and should maintain an average of making timely payment for 95% of all payments. If the Department fails to meet this standard, steps will be taken to determine the cause of delayed payment and to correct the problem, and these steps will be explained to allottees at the regularly scheduled meetings.

5. For 1991 and forward the Department will compile information concerning the timeliness of deposits to IIM accounts and payment to the plaintiff allottees twice a year. This semi-annual report, when completed, will be made available to the allottees upon request and at regularly scheduled bi-monthly meetings between the allottees and the Department. In this settlement agreement, the word "bi-monthly" signifies a frequency of once every 2 months.

#### Interest Payments

6. The plaintiffs have reviewed the Department's system for automatically billing payors for interest on late payment and are satisfied that the established program holds payors accountable for payment of interest on late payments. The Department will make annual reports summarizing the late payment interest

assessed and collected available at the Department's regular meetings with allottees.

7. The Department is also responsible for ensuring that interest is earned on payments received from payors for allottees during the time the funds are held by the Department. The Department has now finalized a computer program which allows interest earned while the funds are held to be distributed with the individual payments. The Department is now able to distribute the interest earned with the payments distributed to the plaintiff allottees.

8. The Department is holding on deposit approximately \$650,000 in undistributed interest earned on payments received for all Indian allottees served by the Department nationwide. The Department will determine what portion of this money is attributable to each BIA Agency Office, and then, for each Agency establish the total royalty income per Allottee per year, take the interest income for each given year and proportionately distribute the interest to the account owners based upon the total income per individual. The Department estimates that it will take approximately 9 months from the date of this agreement to complete the calculations and distribute the money. The plaintiffs agree to this method of distribution and agree that the actual distribution will settle all issues concerning the interest earned on these funds.

Explanation of Payment Reports

9. The Department has substantially revised the explanation of payment report ("EOP") (copy attached as Exhibit A) and the parties are in agreement that the revised EOP report meets the statutory requirements of FOGDMA. The Department is currently distributing the revised EOP report. The Department has worked to make the revised EOP informative and easy to read, allowing allottees to better understand and monitor their royalty payments. The Department intends to continue making improvements and refinements to the report. Allottees will continue to be involved in the improvement process, including consultation on issues such as providing an indication of when late payment interest has been billed.

10. The Department has been distributing the revised EOPs contemporaneously with payments from the IIM accounts by mailing the EOP and the IIM distribution check within the same twenty-four hour period. The Department's current goal is to ensure that the EOP and the check are mailed on the same day. This method of distribution is a substantial improvement over the system previously in operation. However, the Department believes that the best distribution system is one which will allow the EOP and the royalty check to be sent in the same envelope. The Department has developed a proposal for simultaneous distribution. This proposal for simultaneous distribution is to

be implemented by December 31, 1991. The Department will keep the allottees informed of the progress towards our shared goal of simultaneous distribution.

#### Fiscal and Production Accounting Systems

11. In addition to more routine error detection for royalty data, the Department's automated fiscal and production accounting systems either currently perform, or are planned to perform by March 1992, subject to funding, the following automated functions:

- a. comparisons of sales volume data submitted by oil and gas operators on production reports with the sales volume data submitted by payors on monthly royalty reports;
- b. identification of improper recoupments, allowances, and severance tax deductions; and
- c. creation of exception reports to identify all instances where the computed royalty rate differs from the rate established in the lease terms.

Implementation of automated monitoring of all production values on the Department's fiscal and production accounting systems is currently planned for March 1993, dependent on funding.

12. When the automated programs discover a discrepancy on any of the reports which indicates an improper action by the payor/reporter, an "exception" report is automatically generated.

The Department then takes a variety of actions to pursue and resolve exception reports. For the automated functions listed in paragraph 11, the Department is developing annual reports containing statistics and totals by status of resolved and unresolved exceptions which involve a potential underpayment to allottees. The Department will seek input from plaintiffs as to any data and format change subsequent to the initial distribution of these reports. The annual reports will be made available to plaintiffs and their counsel at the end of the first quarter following the end of the calendar year. Copies of the annual reports will routinely be made available at the Department's regularly scheduled bi-monthly meetings with the allottees.

#### Audit

13. The parties have extensively discussed the details of the Department's audit program. Although there was little disagreement as to the details of the Department's comprehensive audit strategy, the plaintiffs were concerned that the audit strategy did not cover a sufficient number of Anadarko Indian allottee leases in a timely manner.

14. In response to this concern the Department has now established an "Indian Spot Audit Team" which, when fully staffed, subject to funding, will have four or more auditors located in Oklahoma City. This staff will augment the normal auditing under the Indian lease audit strategy. The initial



strategy of the Indian spot audit team is to select Indian leases from smaller operators and payors for individual attention. The team will also concentrate on specific royalty issues affecting Oklahoma Indian leases. In general, the leases and payors who are least likely to be audited under the comprehensive audit strategy will be the targets of audits by the spot audit team. The MMS will provide regular summaries of audit status and statistics (including major portion analysis) to allottees as part of the bi-monthly meetings.

Proposal for a Local Office  
and Increased Royalty Compliance Program

15. In the interests of settling the remaining issues in this lawsuit, the Department agrees to implement the following program:

a. By September 1991, the Department will provide a full-time local presence for allottees at the MMS Oklahoma City Office through dedication of at least two external affairs staff experienced in royalty matters. These personnel will increase the frequency of MMS's Anadarko Area allottee contact to bi-monthly meetings to improve communication and to address and resolve allottee inquiries and problems. Local office staff will also provide on-site problem resolution (where possible), perform desk reviews, and report audit and exception processing findings directly to the allottees concerned.

b. Prior to fiscal year 1992, improved royalty verification will be provided by:

- 1) identifying problem payors for the Anadarko Area leases, cleaning-up of current reporting period royalty rate discrepancies, and the misreporting that leads to the discrepancies. In pursuing these problems, the MMS will be cognizant that multiple payors may report partial royalties on Oklahoma leases;

- 2) manual monitoring, sampling and reviewing of reported oil and gas valuation on Anadarko area leases;

- 3) manual sampling and analyzing of actual allowance costs related to Anadarko area leases;

- 4) developing and implementing a prototype automated oil and gas valuation monitoring system for microcomputers to be run for Anadarko area leases. The Department is seeking input from the plaintiffs' representatives as to the design of this system(s); and,

- 5) utilizing the Indian spot audit team in Oklahoma City to increase priority for auditing Anadarko leases by means such as lease/issue based audits, referrals and selective audits of small and intermediate sized payors.

The MMS will consult regularly with allottees concerning the status of the development and implementation of these system and program elements at the bi-monthly meetings.

16. Subject to appropriations from Congress, starting in the first quarter of FY 1992, the Department will proceed to the second phase of the local office by:

a. establishing a full time Oklahoma City sub-office for external affairs with at least three dedicated staff. This office will conduct bi-monthly allottee meetings, and provide on-site problem resolution (where possible) and desk reviews. The local MMS personnel will also report on audit and exception processing findings directly to allottees.

b. As part of this second phase of the program the Department will also improve royalty verification through the following actions:

- 1) implementing routine sampling and review of actual allowance costs underlying Indian allowances;
- 2) developing the capability to have computer generated billings for adjustments to audited periods;
- 3) pursuing and resolving all Indian royalty rate discrepancies (see 15.b.1.); and
- 4) utilizing the local Indian spot audit team to increase Anadarko area audit coverage.

17. The Department will use the experience gained from the first phase of this local office program to assess the actions proposed for the second phase to determine if any changes should be made. The discretion to amend the second phase of the program on this basis is retained by the Department. However, prior to

making any changes to the local office program described in this agreement the Department will consult with the allottees.

Major Portion Analysis

18. Recent study has demonstrated that performing major portion analyses for Indian leases using complete data on gas production in a field or area has not been possible. Attempts to gather complete data through voluntary means from Federal, State and private parties has resulted in deficiencies in the data. Yet, substantial data does exist for many fields or areas which is useful in estimating majority prices. The parties to this litigation agree that a methodology for estimating majority prices fulfills the government's responsibility to ensure that the plaintiffs receive full value for their mineral resources.

19. In light of these facts, and the Department's trust responsibility to Indian lessors, the parties agree to the following major portion methodology:

a. For each field or area by Natural Gas Policy Act. (NGPA) category MMS will determine the statistical best estimates of majority price using the best available data. For each NGPA category, and each month, this value will constitute the minimum royalty value for gas production.

b. Where data on NGPA categories is insufficient to determine separate estimated majority prices for each category,

data will be aggregated and a single estimated majority price will be established.

c. Value will be the higher of the single estimated majority price (to the extent it does not exceed the maximum lawful price for any gas production under the NGPA), or gross proceeds accruing to the lessee.

d. Where sufficient data do not exist to establish majority prices, under either methodology established in "a" or "b" above, value will be calculated according to the applicable gas valuation rules, without regard to the major portion analyses.

e. Calculated minimum values will be communicated to payors with the directive to recalculate and submit any additional royalties and late payment charges.

f. This methodology will be applied to the plaintiff class leases, within the current audit strategy, using data from the Oklahoma Tax Commission. Values derived by this methodology will also be compared to all values reported to MMS from January, 1986 to the date of settlement.

20. The major portion methodology will be incorporated into the current audit strategy by November 15, 1991. The Department will provide a "walk through" of the major portion procedures and will review sample major portion cases with the plaintiff class representatives to provide verification, within one year of the date of settlement.

Miscellaneous

21. The Department will implement a "look-back" program that scans the list of payees of the previous month and notes when a zero appears in the current dispersal. The program will then generate a form letter warning the Indian Allottee that no payment is expected.

22. The plaintiffs agree to waive the right to seek attorney's fees, whether directly or indirectly related to this lawsuit. This waiver is not intended to apply to attorney's fees incurred prospectively in the event plaintiffs initiate legal action to enforce the terms of this agreement.

23. The Department agrees to reimburse the plaintiffs up to \$50,000 in expert's fees and actual out of pocket costs and expenses incurred in the pursuit of this action.

24. Plaintiffs' sole remedy for failure of the Department to implement any or all of the terms of the agreement shall be to move the court to revive the class action for declaratory and injunctive relief.

25. This settlement agreement shall not be construed as an admission of liability on the part of the defendants (or any of their agencies, agents, servants, employees or instrumentalities)

and shall not be used for the purpose of precedent or argument in this or any other case.

26. Nothing herein shall be construed as obligating the Department of the Interior to expend money, or as involving the United States in any contract or other obligation for payment of money in excess of appropriations authorized by law.

27. All paragraphs and provisions of the agreement are adopted by the defendants and shall be implemented by them. However, the defendants shall retain the discretion afforded them by statute and regulation to modify individual provisions based upon changes in applicable law, regulations, executive branch orders or directives, or based upon fiscal or budgetary constraints mandated by Congress, the President, or the Office of Management and Budget. Any executive orders or directives substantially modifying any provisions hereof may be challenged within a reasonable time by revival of this litigation.

28. The terms of this settlement agreement are to be binding on the parties to this suit only -- i.e., the named plaintiffs, the class represented by the named plaintiffs, and

the defendants. Said terms shall not include, affect, or be applicable to any person not a party to this suit.

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IF YOU HAVE QUESTIONS WRITE

Between 8:00 a.m. and 4:00 p.m.  
Mondays - Central Standard Time  
NOTE: Please include Account Number  
and Lease Number in all correspondence

## OIL AND GAS PAYMENT REPORT

Account Number	Check Date	Total Oil and Gas Check Amount
1	2	3
4	5	6
7	8	9
10	11	12
13	14	15
16	17	18
19	20	21
22	23	24
25	26	27
28	29	30
31	32	33
34	35	36
37	38	39
40	41	42
43	44	45
46	47	48
49	50	51
52	53	54
55	56	57
58	59	60
61	62	63
64	65	66
67	68	69
70	71	72
73	74	75
76	77	78
79	80	81
82	83	84
85	86	87
88	89	90
91	92	93
94	95	96
97	98	99
100	101	102

OWNER'S TOTALS ARE  
Totals Reflect Owner Level Information

AC Adjusted Code

Reserved for  
future use

TC Transaction Code

01 - Revenues Due  
02 - Tax  
03 - Recoupment of  
Previous Overpaid Amount

PC Product Code

01 - Oil (Bbl)  
02 - Unprocessed (well) Gas (Mcf)

L Level

1 - Lease Totals at 100%  
A - Allocation  
0 - Owner's Interest Share

### Definition of Fields

- Owner Name and Address:** The address we currently have on file. If this address is incorrect, please notify your BIA office immediately.
- Account Number:** Your individual Indian Affairs Account Number maintained at the Bureau of Indian Affairs - BIA.
- Check Date:** The date that your check to the lessee's attention was issued by the U.S. Treasury.
- Total Oil and Gas Check Amount:** The total dollar amount for which a check was issued to you for the amounts appearing on the statement.
- Reference Number (RN):** A number which identifies each set of government numbers because our system consists of two or three lines.
- Payer Name - Lease Number:** The source of the royalty information reported on these lines.
- Adjustment Code (AC):** This code is used by companies to explain certain transactions they report to the Minerals Management Service (MMS). For example, prior periods and audit adjustments will be explained by this code.
- Transaction Code (TC):** This code explains the reason for the line item appearing on your statement. Examples are revenues due, rents, and recoupments.
- Product Code (PC):** This code explains the type of product for which you are receiving royalties. Examples are oil, condensate, and types of gas.
- Sales Date (Sales M/D/YR):** The month and year of product sales or rent paid.
- Level (L):** This code indicates whether the sales applies to the lease as a whole (L), the statement (A), or the individual owner's portion (0).
- Owner Interest:** The values in this column represent your ownership interest in the lease as on record at the Bureau of Indian Affairs.
- Quantity:** The total production sold from the lease as reported by the payer. This volume is either at the date of owner-level dependent on the level code selected in A & above.
- Unit Value:** The value of each unit of quantity sold. This value is
- Gross Value:** The sales value of the product or the rent reported by the payer.
- Realty Rate-Lease:** The royalty rate at which your royalties should be paid per your contract on file with the BIA.
- Realty Rate-Calculated (RCALC):** The rate at which your royalties are calculated from the sales value. This value is calculated by dividing royalty rate by sales value as reported by the payer. This value may not be equal to your lease rate. When the two values are different, you should contact your BIA office and in turn can contact MMS to research the problem.
- Realty Value or Rent:** The royalty value or rent as reported by the payer.
- Deductions:** Deductions is your royalties or rents as reported by the payer. The deductions are explained with the codes in the Adjustment Code (AC) and/or Transaction Code (TC) columns.
- Owner Share:** The portion of the "Realty Value or Rent" and the "Deductions" which are the Owner's